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C O N F I D E N T I A L SECTION 01 OF 04 SANTO DOMINGO 006124

SIPDIS

DEPT FOR WHA:DESHAZO, WHA/CAR, WHA/EPSC,EB/IFD; TREASURY FOR INTERNATIONAL - NLEE,LLAMONICA; NSC FOR SHANNON; WHITE HOUSE FOR USTR: GASH-DURKIN.

E.O. 12958: DECL: 10/29/2005
TAGS: EFIN PREL PGOV DR
SUBJECT: EMBASSY ASSESSMENT OF DOMINICAN ECONOMIC SITUATION AND GODR POLICY

REF: A) SANTO DOMINGO 5998 B) E-MAIL ESMITH WHA/CAR - KUBISKE 10-24

Classified By: Ambassador Hans Hertell. Reason: 1.5 (b) and (d).

¶1. (C) Summary. The Dominican Republic is moving into very dangerous and uncharted waters. Facing an unstable financial situation with the prospect of a downward economic spiral, President Mejia and his senior advisors have publicly stressed the need to meet IMF standby conditions. They moved on October 23 to raise flagging GODR revenues by imposing a 5.25 percent increase in the levy on imports and then by pushing key business sectors to sign voluntary commitments equivalent at current rates to about USD 10 million per month. The work-up by IMF consultants shows the GODR meeting public sector expenditure targets; our scorecard indicates that various requirements for structural reform are incomplete. Price rises, the steady erosion of the peso, and sporadic demonstrations worry the GODR. Presidential Technical Secretary Carlos Despradel visits Washington this week to ask for a previously approved 100m IDB disbursement for the social sector. The USG response to Dominican concerns provides an opportunity to fortify Mejia and his officials against those in his PPH political faction who prefer to ignore IMF discipline for the presidential election season. See paras 12-14 for assessment. End summary.

DILEMMA: GOOD OF THE NATION VS. PRIVATE ADVANTAGE

¶2. (C) In response to request ref b for its assessment of current economic conditions and their implications, Embassy Santo Domingo considers that the Mejia administration understands the medium- and long-term benefits to the economy of prompt and strict compliance with IMF prescriptions but is struggling with strong resistance from political and economic interests that focus strictly on short term advantage.

IMF COOPERATION

¶3. (C) Dominican financial officials have repeatedly stressed in private to emboffs over the last ten days that the delayed IMF standby arrangement is the only solution to the steadily eroding macroeconomic situation. They tell us that they continue to work closely with IMF staffers here on an unofficial basis. Their fiscal worksheet (faxed to WHA/CAR and Treasury) shows the GODR in compliance with the IMF target on spending. Their shortfall on revenue targets is estimated at RD pesos 1.07 billion per month (about USD 28.5 million).

REVENUE EFFORTS: A PATCHWORK

¶4. (C) The President is leading the effort to raise collections, stymied by his inability to date to convince his majority in Congress to apply the desired 5 percent tax on exports. (His attempt to impose the tax by decree was voided by the Supreme Court.) The Senate has just postponed its consideration of the bill for another week. On October 23 the GODR secured passage by the Monetary Board of an increase in the levy on foreign exchange used for imports from 4.75 percent to 10.0 percent, avoiding the need to resort to the Congress. Presidential Technical Secretary Carlos Despradel estimates that this measure will bring in between 450 and 500 million pesos. (We do not know whether his staff has taken into account the probable drop in import volumes due to sharply higher costs of foreign goods due to inflation and steady devaluation.) The government had previously implemented a temporary two percent import tax that remains in effect.

¶5. (C) To bridge the remaining 500-600 million peso gap, on October 24 and 27 the President resorted to confrontational jawboning of 35 influential business leaders. He has convinced tourism operators, exporters and free trade zone companies that it is in their own interest to help meet the IMF's requirments. Each has signed or will sign a formal agreement this week specifying contributions which, all told, will raise RD pesos 375 million/month. Costs will be passed along almost entirely to consumers, except by the untaxed free zone (FZ) exporters. (FZ companies, earning foreign currency, have benefited directly from devaluation; they will

make a "contribution" indexed to the exchange rate). CONEP, an umbrella business organization, has promised to present a proposal to President Mejia on October 29 on further means of raising the needed funds.

STRUCTURAL CRITERIA - IN PROGRESS, NOT THERE YET

¶6. (SBU) Progress on structural performance criteria has been slower than the IMF had initially prescribed. According to Central Bank staff:

- - Exchange-rate changes are vitually complete; the by-law implementing the Lombard and overnight windows has been approved except for one aspect that the Central Bank expects to resolve the first week of November.

- - The GODR is on track with disposing of the assets of failed BANINTER and with selling Banco Mercantil. The discovery of shady practices at Bancredito may require judicial prosecutions but should not slow down liquidation of the bank.

- - Authorities are reviewing comments from the banking community on proposed regulations for implementing the Monetary and Financial Law.

- - The Law for Bank Resolution is with Congress, and the Central Bank's Monetary Board will meet the congressional leadership during the first week of November.

- - The Government is still consulting with the Fund concerning a Financial Crime Bill.

- - On October 28 Mejia issued a decree setting up a commission to report back within 90 days on procedures and legal changes required in order to reprivatize the electricity distribution companies run by Union Fenosa. He named a widely respected businessman to direct this work.

¶7. (C) Posing a question mark to these steps is last week's Congressional approval of bonds to refinance about 5 million pesos (USD 140 million) of the debt of government-owned Banco de Reservas and the agricultural bank. Though the transaction is presented as a "wash" -- new Central Bank debt retiring claims on Reservas and the agricultural lender -- we are seeking to identify the intended uses and beneficiaries of this money.

POLITICAL AND SOCIAL PRESSURES

¶8. (C) Dominicans are suffering from accelerating inflation, the steadily eroding peso exchange rate, and persistent electricity blackouts. To date, commentators have blamed Mejia and his administration and no one has publicly questioned the need for IMF assistance. Bad news is the staple of the day and no one is expecting things to get better. The prospect of social unrest disquiets many (for example, leading newspaper "Hoy" displayed a full color front-page photo of street demonstrators attempting to set off a homemade bazooka.)

¶9. (SBU) Among points to note:

- - Inflation is up from 8 percent in CY 2002 to near 40 percent predicted for CY 2003. Households face 50-100 percent increases in staples such as milk, cooking oil, meats, rice, beans and cereals. Medicines are up 30 percent. Regular gasoline has gone up about 40 percent since January.

- - Record numbers of Dominicans are attempting the hazardous journey by boat to Puerto Rico. Prospective illegal immigrants to the United States now include some from the middle class.

- - The press regularly reports reduced services or closures of public health facilities.

- - Government social spending is at a standstill and even salary checks are delayed.
- - Electricity blackouts will get much worse before they get better. Available supply nationwide is 1463 megawatts, for estimated peak demand of 1855 megawatts. Plants are running out of fuel. Next week capacity will fall 250 megawatts and by mid-November two additional plants will probably shut down for lack of GODR payment, bringing capacity down to about 750 megawatts. The South (including the traffic-choked capital, Santo Domingo) will begin to experience the persistent failures like those which provoked street protests in the North.

IMF-BASHERS

¶10. (C) Our GODR interlocutors have told us that some parts of the government and political parties want to take an aggressive approach to the IMF. President Mejia emphatically

rejected such a course when speaking to the Ambassador on October 28, but he acknowledged that these sentiments exist.

¶11. (C) The armed forces have not shown any desire to blame the IMF, even though their institution is largely immobilized by budget shortfalls. The military leadership is loyal to the PRD.

¶12. (C) We believe that the President's own "PPH" faction, chaired by Agriculture Secretary Eligio Jacquez, is the most restive. They face the dilemma of a virtually certain renomination of Mejia in late November without any clear prospect at this time for a winning electoral strategy. They are probably tempted to push Mejia to ignore Fund constraints and to borrow and spend to bolster his campaign against Leonel Fernandez of the PLD. The PRD-dominated legislature is probably uneasy, as well, as constituents feel the economic plight.

ASSESSMENT

¶13. (C) Technical Secretary Carlos Despradel told us on October 24 that the Government can "get along" through the end of the year, but would be able to do nothing more than pay salaries. (In fact, we understand that paychecks have been delayed; the Government is in arrears to civil servants.) Despradel was visibly unhappy and tense when he visited the Ambassador on October 27 to ask for USG sympathy in obtaining release of the USD 100 million disbursement pending at the InterAmerican Development Bank to complete a Social Sector loan.

¶14. (C) There is a difference between "getting along" and the more important consideration of keeping the GODR committed to structural adjustment. We need the Mejia administration to stay on board. We are sailing into a storm right now; financial indicators, already unstable, are likely to take a vigorous kick when the public begins to react to further deterioration in their daily living conditions. September protests and riots in the North were prompted largely by mischief-making local opposition politicians. Unless the President can convince the Dominican public that relief, though distant, is in sight, we see a possibility of real conflict in the streets, across the country.

¶15. (C) President Mejia vows that he will not beg; he says that he would prefer to resign rather than to order repression. Some of this is characteristic Hipolito exuberance, but he pointedly cited to the Ambassador, several times, the example of Bolivia's Sanchez Losada. Mejia wants to deliver on his promises to the barrios and his list of small-scale uncompleted projects, both to do good and to do well in the elections.

RECOMMENDATION

¶16. (C) Embassy recommends that the USG keep the pressure up on the GODR to continue needed economic and financial measures, including by withholding the bulk of the delayed IFI disbursements, but that the USG support a one-time lifeline in the form of the $100 million disbursement by the IDB for highly visible and widely spread social sector projects. Otherwise, given the increasingly turbulent situation, we run the risk, as is said here, of "finding that when the hats are finally ready, there will be no heads to receive them."

HERTELL